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No. 01-1348

In the Supreme Court of the United States

NANCY J. HUKKANEN-CAMPBELL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The Commissioner of Internal Revenue asserts that this Court should deny certiorari in this case "[f]or the same reasons stated in [his] brief in opposition to the petition for a writ of certiorari in *Benci-Woodward* [*v. Commissioner*, No. 00-592]." Opp. 5. In his brief in opposition in *Benci-Woodward*, the Commissioner argued that this Court should deny certiorari on essentially the same issue as the one presented by this case because no conflict among the circuits existed. *B-W* Opp. 5-7.[1] This was true, according to his *Benci-Woodward* opposition, because the Ninth Circuit's rejection of the contrary precedent of three other circuits in *Benci-Woodward* was based on differences in State law. *Ibid.*

However, since the filing of the Commissioner's brief in opposition in *Benci-Woodward*, the Ninth Circuit has abandoned the State-by-State approach it applied in that case in favor of a uniform national standard. See *Sinyard v. Commissioner*, 268 F.3d 756, 760 (9th Cir. 2001). Furthermore, during the last year, several other circuit courts of appeals have had the opportunity to decide the issue presented by this case and have uniformly rejected an analysis that depends upon State law and have recognized the split among the circuits. Thus, whatever merit the Commissioner's ground for opposing the *Benci-Woodward* petition may have had at the time of this Court's consideration of that petition, subsequent decisions have established that the Commissioner's argument that no circuit split exists because the Federal tax issue turns on State law is no longer valid.

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1 References to "*B-W* Opp." are to the Commissioner's brief in opposition to the petition in *Benci-Woodward*.

The Tenth Circuit's decision in this case did not rely upon State law, and its holding is in direct conflict with the decisions of the Fifth, Sixth, and Eleventh Circuits. Furthermore, its analysis is inconsistent with this Court's decisions establishing the boundaries of "income" for purposes of the tax law.

I. THE COMMISSIONER'S ASSERTION THAT NO CIRCUIT SPLIT EXISTS BECAUSE EACH CASE TURNS UPON STATE LAW HAS BEEN UNIFORMLY REJECTED.

Since the time of the Commissioner's filing of his opposition to the *Benci-Woodward* petition, which he incorporates by reference in his opposition in this case (at 5), the Ninth Circuit (which decided *Benci-Woodward*), the Tenth Circuit (in this case), other courts of appeals, and commentators have uniformly rejected the premise of the Commissioner's argument, *i.e.* that the conflicting decisions of the various courts of appeals turn upon the State law governing the attorney-client relationship.

A. The Ninth Circuit Has Abandoned Its State-By-State Analysis, Applied In *Benci-Woodward*, In Favor Of A Uniform National Approach Under Which Its Position Is In Conflict With Other Circuits' Decisions.

In his opposition to the *Benci-Woodward* petition, the Commissioner correctly referred this Court to the Ninth Circuit's reliance in that case on differences in State attorney lien laws, which the court used to distinguish the contrary

precedents of the Fifth and Sixth Circuits.[2] *B-W* Op. 6-7, citing *Benci-Woodward*, 219 F.3d at 943. The Ninth Circuit relied heavily on differences in State law in distinguishing those contrary precedents in that case. *Ibid.*

However, in *Sinyard*, decided several months after this Court's consideration of the *Benci-Woodward* petition,[3] the Ninth Circuit reversed course. In *Sinyard*, the court of appeals considered a situation in which the relevant contingent fee contract was governed by Alabama law—the same State law that governed in *Cotnam*. The Ninth Circuit addressed the taxpayer's argument that the rule of *Cotnam* should apply because the Alabama attorney lien statute applied:

> We do not dispute the old Fifth Circuit's statement of Alabama law [as creating a lien on the recovery in favor of the lawyer], but we do not see how the

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2 The contrary decisions of the Fifth and Sixth Circuits distinguished in *Benci-Woodward* were *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), and *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000). The Ninth Circuit's opinion did not cite or address the later decision of the Fifth Circuit, reaffirming its *Cotnam* holding, in *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000), or the Eleventh Circuit's decisions in *Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001), and *Barlow-Davis v. Commissioner*, 210 F.3d 1346 (11th Cir. 2000). *Benci-Woodward*, 219 F.3d at 943.

3 The Ninth Circuit's *Sinyard* decision was also issued several months after this Court's consideration of the petition for a writ of certiorari in *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000), *cert. denied*, 532 U.S. 972 (2001). The Ninth Circuit applied the same State-by-State approach in *Coady* as it did in *Benci-Woodward*—the approach it later repudiated in *Sinyard*.

> existence of a lien in favor of the taxpayer's creditor makes the satisfaction of the debt any less income to the taxpayer whose obligation is satisfied. Like the Tax Court, we decline to follow *Cotnam*.

Sinyard, 268 F.3d at 760. The Ninth Circuit's departure in *Sinyard* from its State-by-State approach of *Benci-Woodward* was confirmed by the dissenting judge. *Sinyard*, 268 F.3d at 761 n.1 (McKeown, J., dissenting) ("The majority appears to conclude that state law is irrelevant to the taxability of a contractually-determined attorney's fee").

With its decision in *Sinyard*, the Ninth Circuit joined other circuits (as discussed in the following subsection) in rejecting an analysis that relies upon differences in State attorney lien statutes. Thus, the Commissioner's assertion in his opposition to the *Benci-Woodward* petition that no circuit split exists because the issue turns on State law is no longer valid. Accordingly, his incorporation of that stale assertion in his opposition to the petition in this case (at 5) is without merit.

B. The Split Among The Circuits On The Federal Income Tax Question Presented By This Case Is Widely Recognized.

The Ninth Circuit is not the only court of appeals that has acknowledged that its precedents are in conflict with those of the Fifth, Sixth, and Eleventh Circuits. The Tenth Circuit itself in this case noted that "the majority of the circuits" have rejected the holdings of the Fifth, Sixth, and Eleventh Circuits, citing the decisions of four circuits. Pet. App. 3a. The Tenth Circuit also "agree[d] with Petitioner that a universal standard independent of the 'intricacies of [an]

attorney's bundle of rights,' or the unique provisions of a particular state's attorney lien statute is desirable." Pet. App. 4a, quoting *Srivastava*, 220 F.3d at 364. Thus, the Tenth Circuit's opinion in this case is inconsistent with the borrowed ground for opposition of the petition offered by the government. Compare *B-W* Opp. 6-7, Pet. App. 4a.

As outlined in detail in the petition (at 13-14), other circuits have carefully explained that their decisions do not turn upon differences in State law. Some of these courts of appeals have explained their non-reliance on State law in the time since this Court's consideration of previous petitions for a writ of certiorari[4] on the issue presented in this case. See *Kenseth v. Commissioner*, 259 F.3d 881, 883-884 (7th Cir. 2001) ("There is nothing exotic about this analysis—nothing, indeed, that depends on the particular contractual setting * * * out of which this case arises"); *Young v. Commissioner*, 240 F.3d 369, 378-379 (4th Cir. 2001). In at least one case, the sole question was whether differences in State law justified deviating from circuit precedent. *Srivastava*, 220 F.3d at 357-358 (deciding that any differences in Texas attorney lien statute did not justify departure from *Cotnam*, which involved an attorney-client relationship governed by Alabama law).

As a result of their views that the issue raised by this case does not turn on State law, courts of appeals have often explicitly recognized the split among the circuits.[5] See

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4 The petition in *Benci-Woodward* was denied January 16, 2001 (531 U.S. 1112) and the petition in *Coady* was denied April 16, 2001 (532 U.S. 972).

5 Legal commentators and national media have also drawn attention to the split among the circuits. See Pet. 17 and sources

Kenseth, 259 F.3d at 883 ("The circuits are split on whether a contingent fee is * * * a part of the client's taxable income"); *Young*, 240 F.3d at 379 (joining "the majority of those circuits to have addressed this issue"). The Eleventh Circuit has recognized the split in the course of awarding a taxpayer litigation costs under 26 U.S.C. § 7430, holding that the Commissioner was not "substantially justified" in pursuing his position that contingent attorney's fees constitute income to the successful plaintiff in light of the Eleventh Circuit's clearly-enunciated position on the circuit split, stating:

> In its appeal brief, the government lists the circuits where it is litigating the *Cotnam* issue, and includes a list of circuits where it has won and where it has lost. However, the IRS should not expect the individual taxpayer to fund its crusade to change the law. While other circuits may include contingency fees paid to attorneys in a taxpayer's gross income, *Cotnam* is clearly the law of this circuit.

Foster v. United States, 249 F.3d 1275, 1280-1281 (11th Cir. 2001).

The courts of appeals understand that they are split on the issue presented by this case. The Commissioner's assertions to the contrary should be rejected.

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cited therein; see, *e.g.*, Tom Herman, *Tax Report*, WALL ST. J., Aug. 2, 2000, at A1 (labeling the circuit split on this issue "a confusing jumble that the Supreme Court may have to untangle").

II. THE TENTH CIRCUIT'S DECISION IS INCONSISTENT WITH THIS COURT'S PRECEDENT ON INCOME RECOGNITION.

Our petition (at 18-29) catalogued the various ways in which the Tenth Circuit's analysis in this case deviated from decades of this Court's precedents on the definition of "income" and the application of the "assignment-of-income" doctrine. In response, the Commissioner asserts summarily (at 5) that "[t]he decision of the court of appeals is correct."

Similarly, the Commissioner's opposition in *Benci-Woodward* does not directly refute petitioner's analysis regarding the inconsistencies between the Tenth Circuit's decision and this Court's precedents. In its one paragraph addressing the correctness of the court of appeals' legal analysis, the Commissioner asserted:

> Because petitioners thus retained full ownership of their cause of action, it necessarily follows that the entire amount of the punitive damages awarded to them [including the attorney's fees portion] must be included in their gross income under 26 U.S.C. 61(a).

B-W Opp. 5. In support of this "full ownership" standard, which has no basis in the Internal Revenue Code or judicial analysis, the Commissioner cited only *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). *B-W* Opp. 5.

Legal ownership of income is not the determining factor in analyzing income recognition for tax purposes. The simplest example of this point is the treatment of loan proceeds under the tax law. A borrower who receives funds from a lender has indisputable legal title to the funds

borrowed. Nevertheless, it is established beyond question that a loan does not give rise to income to the borrower because of the obligation to repay. See *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983).

Rather, the test for income recognition established by this Court's precedents is whether the taxpayer has complete dominion and control over the income. See Pet. 18-20; *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 208-210 (1990).

> The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.

Commissioner v. Sunnen, 333 U.S. 591, 604 (1948).

The sole case cited by the government as justifying the Ninth Circuit's decision in *Benci-Woodward*, and presumably therefore the Tenth Circuit's decision in this case, is *Glenshaw Glass*. *B-W* Opp. 5. *Glenshaw Glass* established the now-uncontroversial proposition that punitive damages constitute income to the recipient plaintiff. *Glenshaw Glass*, 348 U.S. at 431-433. Accordingly, and particularly in light of the government's citation of it without further explanation, the relevance of *Glenshaw Glass* to the correctness of the Tenth Circuit's analysis is negligible.

Any relevance that *Glenshaw Glass* has, however, actually supports petitioner's assertion that the Tenth Circuit's analysis is inconsistent with this Court's. In *Glenshaw Glass*, the Court recited the test that petitioner asserts the Tenth

Circuit should have applied: whether the payments at issue are "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.* at 431.

As explained in the petition (at 9-12, 20-22), applying this Court's tests to this case, Ms. Hukkanen did not have the dominion and control over the attorneys' fees portion of the defendant's payment necessary to impute the receipt of taxable income to her. Ms. Hukkanen never had possession of those funds, nor could she ever have disgorged those funds from her attorneys on account of the statutory and contractual lien on the proceeds her attorneys possessed. Ms. Hukkanen had "lost [her] right to receive payment for the lawyer's portion of the judgment." *Estate of Clarks*, 202 F.3d at 856; see also *Cotnam*, 263 F.2d at 126 ("In our opinion, it is as illegal as it is unjust to tax [plaintiff] on [the attorney's fees portion] which did not pass through her hands and of which she never had control"). The value of Ms. Hukkanen's lawsuit "was entirely speculative and dependent on the services of counsel" at the time she retained her attorneys. *Estate of Clarks*, 202 F.3d at 857. Ms. Hukkanen did not possess the necessary dominion and control over the attorneys' fees portion of the lawsuit proceeds, and the Tenth Circuit's holding that those funds represented income to her is in conflict with this Court's precedents.

III. THE CIRCUIT SPLIT ON THE ISSUE RAISED BY THIS CASE LEADS TO ARBITRARY DIFFERENCES IN TAX TREATMENT AND ABSURD RESULTS.

Under the current state of the law, taxpayers who reside in the Fifth, Sixth, or Eleventh Circuits at the time they file a

petition in the Tax Court challenging their tax liability are entitled to exclude the attorney's fee portion of taxable lawsuit recoveries from their income. See Pet. 8 n.6; 26 U.S.C. § 7482(b)(1)(A). Even under the narrow interpretation of those circuits' precedents espoused by the Commissioner in his opposition to the petition (at 5), taxpayers whose relationships with their attorneys are governed by the law of Alabama, Texas, or Michigan can exclude the attorney's fees portion of lawsuit proceeds from their incomes. See *Foster*; *Srivastava*; *Estate of Clarks*.

The Commissioner's position that no circuit split exists because each case turns upon State law, if allowed to stand, would require every circuit court of appeals to determine the legal effect of each State's attorney lien law. That is because there is no necessary correlation between the State law that governs a taxpayer's attorney-client relationship (which the Commissioner asserts controls the tax result) and the circuit in which a taxpayer resides at the time of his filing of a Tax Court petition (which controls the circuit law that applies when the taxpayer litigates his tax liability).

This Court should grant the petition and resolve the split among the circuits to promote uniformity in the application of the Federal income tax laws on this fundamental and recurring issue.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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